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No. 97-147

In the Supreme Court of the United States

OCTOBER TERM, 1997

ATLANTIC MUTUAL INSURANCE CO. AND INCLUDIBLE SUBSIDIARIES, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT

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48 pp

QUESTION PRESENTED

Whether 26 C.F.R. 1.846-3(c) correctly interprets the term "reserve strengthening" as used in Section 1023(e)(3)(B) of the Tax Reform Act of 1986.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A25) is reported at 111 F.3d 1056. The opinion of the Tax Court (Pet. App. A26-A47) is unofficially reported at 71 T.C.M. (CCH) 2154 (1996).

JURISDICTION

The judgment of the court of appeals was entered on April 24, 1997. The petition for a writ of certiorari was filed on July 22, 1997, and was granted on October 20, 1997 (118 S. Ct. 334). The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATUTORY PROVISION AND REGULATION INVOLVED

The relevant portions of Section 1023(e) of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2404, and Section 1.846-3(c) of the Treasury Regulations on Income Tax, 26 C.F.R. 1.846-3(c), are set forth at Pet. App. A48-A49, A52-A54.

STATEMENT

1. Petitioner is a property and casualty (P & C) insurance company (Pet. App. A6). Such companies maintain an accounting reserve for their "unpaid losses." The reserve for unpaid losses consists of amounts that each insurer estimates it will ultimately be required to pay (i) on losses already reported ("case reserves"), (ii) on losses not yet reported but estimated to have occurred ("incurred but not reported loss reserves") and (iii) in connection with the determination and adjustment of such losses ("loss adjustment expense reserves") (*id.* at A6 n.4).

During the 1986 taxable year, petitioner made net additions to the reserves it maintained for accidents that occurred prior to that year.[1] Those additions were not attributable to changes in the methods of estimation (Pet. App. A45). Instead, they were the result of additional experience on the loss claims and "routine adjustments" of reserves by claims adjusters and management (*ibid.*).

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[1] Petitioner's "case reserves" totaled $255,655,141 at the end of 1985 and $277,705,661 at the end of 1986 (J.A. 34 ¶ 29). Petitioner's reserves for losses that were "incurred but not reported" totaled $93,713,687 at the end of 1985 and $111,708,986 at the end of 1986 (J.A. 34-35 ¶ 30). Petitioner's reserves for "loss adjustment expense" totaled $72,317,450 at the end of 1985 and $84,066,519 at the end of 1986 (J.A. 37 ¶ 36).

As applied to reserves of the type involved in this case, Section 1.846-3(c)(3) of the Treasury Regulations defines the term "reserve strengthening" as used in Section 1023(e)(3)(B) of the Tax Reform Act of 1986 to include any additions made to reserves, even if stemming from routine adjustments. The Commissioner of Internal Revenue therefore determined that the increases to petitioner's reserves for losses occurring prior to 1986 constituted "reserve strengthening" under Section 1023(e)(3)(B) of the Tax Reform Act of 1986 (Pet. App. A7). Based on that determination, petitioner was required to recognize additional taxable income of $1,339,039 for 1987, with a resulting deficiency in tax of $519,987 for that year (*ibid.*).

2. Petitioner commenced this action in the Tax Court to contest the deficiency determination of the Commissioner (Pet. App. A7).

a. The issue addressed in this case is whether Section 1.846-3(c) of the Treasury Regulations, 26 C.F.R. 1.846-3(c), correctly defines the term "reserve strengthening," as used in Section 1023(e)(3)(B) of the Tax Reform Act of 1986, to include increases to reserves attributable to routine claims adjustment. That issue was first considered by the Tax Court in *Western National Mutual Insurance Co.* v. *Commissioner*, 102 T.C. 338 (1994), aff'd, 65 F.3d 90 (8th Cir. 1995). In that case, the taxpayer argued that the term "reserve strengthening" is understood in the insurance industry to involve only those increases to reserves that result from changes in the assumptions or methodology used to compute reserves. The taxpayer contended in that case, as petitioner does here, that the term does not encompass the type of increases to unpaid loss reserves that result from routine claims processing. 102 T.C. at

346-347. The taxpayer in *Western National* introduced expert testimony that purported to establish the technical meaning of the term "reserve strengthening" in the insurance industry. The Commissioner did not offer any opposing expert testimony in that case. Instead, the Commissioner relied on the legislative history of Section 1023(e)(3)(B) to support the definition of the term "reserve strengthening" contained in the agency's interpretive regulation. 102 T.C. at 347.

In *Western National*, the Tax Court invalidated the regulation in a reviewed opinion with four judges dissenting. The majority relied on the taxpayer's expert witnesses in concluding that the term "reserve strengthening" has an "industry meaning" that is narrower than the definition contained in the agency's regulation. 102 T.C. at 360. The court concluded that Section 1023(e)(3)(B) of the Tax Reform Act of 1986 incorporates the "industry usage" of the term and is therefore "neither ambiguous nor imprecise" (*id.* at 360 & n.25). Because the regulation conflicts with the "industry meaning" of the term "reserve strengthening," the court concluded that the regulation conflicts with the statute and is therefore invalid. On appeal, the Eighth Circuit affirmed. 65 F.3d 90 (1995).

b. In the present case, both the Commissioner and the taxpayer introduced expert reports at trial that addressed the meaning of "reserve strengthening" in the property and casualty industry. Those expert reports, which are summarized in detail by the courts below, "ma[de] clear that the term 'reserve strengthening' as used in section 1023(e)(3)(B) is subject to more than one interpretation" (Pet. App. A9 & n.5). See also *id.* at A43; pages 18-20, *infra*.

The Tax Court nonetheless again concluded that the taxpayer was not liable for the asserted deficiency (Pet. App. A27). The court stated that its prior decision "was not based solely on expert testimony" (*id.* at A46) but had also been supported by (i) the use of the term "reserve strengthening" in other legislation and (ii) the legislative history of the statute involved in this case (*ibid.*). In discussing the legislative history of Section 1023(e)(3)(B) in this case, however, the court acknowledged that the Conference Committee "substantially revised the 'reserve strengthening' language contained in both the Senate bill and in the accompanying Senate Finance Committee Report," which had limited reserve strengthening to changes in reserve practices (Pet. App. A36). The court further noted that the Conference Committee Report "provided a more expansive definition of the term [reserve strengthening] than that contained in the Finance Committee report" (*id.* at A38). The court therefore agreed that the agency's regulation "provided a definition of 'reserve strengthening' consistent with the conference committee report" (*id.* at A41). But, in *Western National*, the court had emphasized that the Conference Committee Report *also* states that the limitation on "reserve strengthening" is designed "to prevent taxpayers from artificially increasing" reserves (*id.* at A42, quoting H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. at II-367 (1986)). The court reasoned that this reference to artificial adjustments refers "to changes in assumptions or methodology" rather than routine loss adjustments (Pet. App. A42). The court ultimately concluded that, despite the Commissioner's "cogent arguments to the contrary," principles of *stare deci-*

sis required it to adhere to its prior decision in *Western National* (*id.* at A45).

3. The court of appeals reversed (Pet. App. A1-A25). The court concluded that there is no plain meaning, or consistent industry usage, of the term "reserve strengthening" as that term is used in Section 1023(e)(3)(B) of the Tax Reform Act of 1986. To the contrary, the court observed that the "expert testimony here makes clear that the term 'reserve strengthening' as used in [the statute] is subject to more than one interpretation" (Pet. App. A9 & n.5). In view of "the lack of an explicit statutory definition of reserve strengthening" and "the conflicting definitions of reserve strengthening provided by the expert witnesses," the court held that "the Tax Court erred as a matter of law in holding that the meaning of reserve strengthening in section 1023(e)(3)(B) was plain" (Pet. App. A15).[2]

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[2] The court of appeals also stated that the Tax Court erred in *Western National* by relying on the meaning of the term "reserve strengthening" as used in the *life* insurance industry. The court explained that the meaning of "reserve strengthening" in the life insurance industry has no direct relevance to the meaning of that term in the property and casualty insurance industry (Pet. App. A12-A13):

> [L]ife insurance companies and P & C insurers are taxed in entirely separate manners. Gross income as well as loss reserves are computed on different bases and assumptions. Actuarial assumptions about interest rates and mortality rates are an integral part of computing future losses which form the basis of the loss reserves in life insurance. On the other hand, P & C loss reserves are determined primarily based on past claims experience and the judgments of the individual claims adjusters.

Finding the words of the statute to be ambiguous, the court concluded that it was required by *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), "to take a deferential approach to ascertaining whether the agency's interpretation is a permissible one" (Pet. App. A15). The court emphasized that "where reasonable minds may differ * * * , courts should defer to the informed experience and judgment of the agency to whom Congress delegated appropriate authority" (*id.* at A24 n.13, quoting *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 371-372 (1973)). The court held that the broad definition of "reserve strengthening" contained in the regulation satisfies this deferential standard because the agency's interpretation is consistent with the language of the statute, its history and its underlying purpose (Pet. App. A15-A25).

SUMMARY OF ARGUMENT

The definition of "reserve strengthening" set forth in the Treasury Regulation that interprets Section 1023(e)(3)(B) of the Tax Reform Act of 1986 should be sustained because it is consistent with the text and history of the statute and advances the legislative purpose. The term "reserve strengthening" has no statutory definition or common meaning manifested either in industry usage or in prior legislation. Instead, as the court of appeals correctly concluded in this case, "the term 'reserve strengthening' as used in section 1023(e)(3)(B) is subject to more than one interpretation" (Pet. App. A9).

The Treasury's interpretation of this ambiguous statutory term is supported by the structure and history of the statute. The original Senate version of this statute had contained explicit language that

would have narrowly limited the concept of "reserve strengthening" to changes in reserves caused by changes in reserve methodologies. The Senate version of the statute, however, was expressly rejected by the Conference Committee. The definition of "reserve strengthening" contained in the agency's regulation coincides precisely with the definition of that term in the Conference Committee Report, which explains that "reserve strengthening" "include[s] *all additions to reserves attributable to an increase in an estimate of a reserve established for a prior accident year*" (Pet. App. A17, quoting H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. at II-367 (1986)) (emphasis added). Petitioner ignores this clear legislative history and instead advances the untenable proposition that the Court should adopt the very version of Section 1023(e)(3)(B) that had been proposed by the Senate but rejected by the Conference Committee. As this Court has emphasized, however, courts have a "duty to refrain from reading a phrase into the statute when Congress has left it out." *Keene Corp.* v. *United States*, 508 U.S. 200, 208 (1993).

The Treasury's interpretatation of the statute honors the crucial distinctions that occupied the attention of Congress in enacting this legislation. By faithfully adhering to the text of the statute and the legislative intent, the agency has implemented "the congressional mandate in [a] reasonable manner" and its regulation therefore "must be upheld." *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 476 (1979), quoting *United States* v. *Cartwright*, 411 U.S. 546, 550 (1973), quoting *United States* v. *Correll*, 389 U.S. 299, 307 (1967).

ARGUMENT

THE TREASURY REGULATION CORRECTLY DEFINES THE TERM "RESERVE STRENGTHENING" IN SECTION 1023(e)(3)(B) OF THE TAX REFORM ACT OF 1986 TO REFER TO ANY ADDITIONS MADE DURING 1986 TO THE RESERVES ESTABLISHED BY PROPERTY AND CASUALTY INSURERS FOR LOSSES INCURRED PRIOR TO THAT YEAR

1. *The Origin of the Statute and Regulation.* Section 832(c)(4) of the Internal Revenue Code authorizes a deduction for "losses incurred" in computing the taxable income of property and casualty insurance companies. 26 U.S.C. 832(c)(4). Prior to 1986, the term "losses incurred" was defined by Section 832(b)(5) of the Code to mean the amount of "losses paid" during the year plus the increase (or minus the decrease) in "unpaid losses." 26 U.S.C. 832(b)(5) (1982).[3] That pre-1986 provision gave an unwarranted benefit to property and casualty companies, for it failed to take the time value of money into account in determining the permissible deduction. See S. Rep. No. 313, 99th Cong., 2d Sess. 499-500 (1986); note 3, *supra*.

Congress attempted to solve this problem by adding Section 846 to the Code as part of the Tax Reform Act of 1986, Pub. L. No. 99-514, § 1023(c), 100 Stat. 2399.

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[3] A property and casualty company was permitted to deduct the full amount of the estimated loss in the year the loss occurred, even though the claim might not be paid for several years. When the claim was paid, the company would not receive any additional deduction (assuming that the payment equalled the original estimate) because the payment would be offset by a corresponding reduction in its loss reserves.

That Section requires unpaid losses to be discounted to present value when claimed as a deduction. 26 U.S.C. 846. As part of the same legislation, Congress amended Section 832(b)(5) to reflect the new discounting requirements. Under that new Section, the deduction for "losses incurred" is computed by adding to losses paid "all discounted unpaid losses (as defined in section 846) outstanding at the end of the taxable year" and deducting therefrom "all discounted unpaid losses outstanding at the end of the preceding taxable year." 26 U.S.C. 832(b)(5)(A).

Congress enacted a series of transitional rules to implement these new accounting procedures. Section 1023(e)(1) of the Tax Reform Act of 1986 specifies that the new discounting rules "shall apply to taxable years beginning after December 31, 1986." 100 Stat. 2404. As the Tax Court noted (Pet. App. A34), if no exception had been made to this new requirement, property and casualty companies would have been required to compare "old law" (undiscounted) year-end 1986 reserves with "new law" (discounted) year-end 1987 reserves, thus causing a one-time reduction of the losses incurred deduction in 1987. To avoid that sharp consequence, Congress established a transitional rule—Section 1023(e)(2) of the Tax Reform Act of 1986—which specifies that, in computing the 1987 deduction for losses incurred, the year-end 1986 reserves are also to be discounted to present value.

Without any further transitional provision, this special rule would have required property and casualty companies to take into income in 1987 the excess of the undiscounted year-end 1986 reserves over the discounted year-end 1986 reserves. This is because (i) the new requirement of discounting constitutes a change of accounting method, (ii) that new accounting

method yields a double deduction for property and casualty companies[4] and (iii) Section 481(a) of the Code requires an appropriate adjustment to prevent the taxpayer from obtaining a double deduction created by a change in accounting method.[5] Congress decided to permit taxpayers to obtain a limited double

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[4] The double deduction may be illustrated as follows:

No discounting. Assume that an automobile accident occurs in Year 1, and the insurance company estimates it will eventually pay a total of $10 in claims stemming from that accident. Assume further that the $10 is in fact paid out in Year 5.

The tax treatment is as follows: In Year 1, the company adds $10 to its "unpaid losses," and obtains a deduction of $10. In Year 5, when the company makes the payment, it increases its "losses paid" by $10, but reduces its "unpaid losses" by $10. This is a wash.

With discounting. Assume the same facts as above. Assume, in addition, that discounting goes into effect in Year 4, and the company's "unpaid losses" account is reduced in that year, tax-free, to $9.

The tax treatment is as follows: The company again gets a Year 1 deduction of $10. In Year 5, however, when the company makes the payment, it increases its "losses paid" by $10, but reduces its "unpaid losses" by only $9, and thus gets a net additional deduction of $1. The company thus gets a total deduction (in Year 1 and Year 5) of $11 for a $10 payment.

[5] Under Section 481(a) of the Code, if the taxpayer's taxable income is computed "under a method of accounting different from the method under which the taxpayer's taxable income for the preceding taxable year was computed," then "there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted * * *." 26 U.S.C. 481(a).

deduction in this particular situation, however, by enacting a "fresh start" provision in Section 1023(e)(3)(A) of the Tax Reform Act of 1986. Section 1023(e)(3)(A) provides (100 Stat. 2404):

> (3) FRESH START.—
>
> (A) IN GENERAL.—Except as otherwise provided in this paragraph, any difference between—
>
> (i) the amount determined to be the unpaid losses and expenses unpaid for the year preceding the 1st taxable year of an insurance company beginning after December 31, 1986, determined without regard to paragraph (2) [*i.e.*, without discounting], and
>
> (ii) such amount determined with regard to paragraph (2) [*i.e.*, with discounting],
>
> shall not be taken into account for purposes of the Internal Revenue Code of 1986.

The double deduction provided by the "fresh start" provision gave property and casualty companies an incentive to increase their unpaid-loss reserves during the 1986 taxable year. See Logue, *Toward a Tax-Based Explanation of the Liability Insurance Crisis*, 82 Va. L. Rev. 895, 925-930 (1996). Congress addressed that problem by enacting Section 1023(e)(3)(B) of the Tax Reform Act of 1986, which precludes application of the "fresh start" provision—and thus permits the normal application of Section 481(a)—with respect to any "reserve strengthening"

that occurred in 1986. Section 1023(e)(3)(B) provides (100 Stat. 2404):[6]

> (B) RESERVE STRENGTHENING IN YEARS AFTER 1985.—Subparagraph (A) [the fresh start provision] shall not apply to any reserve strengthening in a taxable year beginning in 1986, and such strengthening shall be treated as occurring in the taxpayer's 1st taxable year beginning after December 31, 1986.

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[6] The enacted version of this "reserve strengthening" provision differs from the version contained in the bill approved by the Senate Finance Committee. That bill had explicitly linked reserve strengthening to a change in the insurer's reserve practice. It provided (H.R. 3838, 99th Cong., 2d Sess., § 1022(e)(3)(B) (1986), as reported by the Senate Finance Committee, May 29, 1986) (emphasis added):

> (B) *Reserve Strengthening After March 1, 1986.* * * * [The fresh start adjustment] shall not apply to any reserve strengthening reported for Federal income tax purposes after March 1, 1986, for a taxable year beginning before January 1, 1987, and such strengthening shall be treated as occurring in the taxpayer's 1st taxable year beginning after December 31, 1986. *The preceding sentence shall not apply to the computation of reserves on any contract if such computation employs the reserve practice used for purposes of the most recent annual statement filed on or before March 1, 1986, for the type of contract with respect to which such reserves are set up.*

See 132 Cong. Rec. 16,130-16,131 (1986). The Senate Report stated that "[t]he committee intends that any adjustments to reserves that are attributable to changes in reserves on account of changes in the basis for computing reserves (i.e., reserve strengthening or reserve weakening) in a taxable year beginning before January 1, 1987, are not taken into account in determining taxable income after the effective date." S. Rep. No. 313, *supra*, at 510.

The Conference Committee Report explains the application of this provision (H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. at II-367 (1986)) (emphasis added):

Fresh start adjustment

The conference agreement follows the Senate amendment with respect to providing a fresh start adjustment—i.e., a forgiveness of income—for the reduction in reserves resulting from discounting the opening reserves in the first post-effective date taxable year of the provision. The conference agreement modifies the Senate amendment with respect to the treatment of reserve strengthening under the fresh start income forgiveness provision. Under the conference agreement, reserve strengthening in taxable years beginning after December 31, 1985, is not treated as a reserve amount for purposes of determining the amount of the fresh start. Instead, such reserve strengthening additions to loss reserves in taxable years beginning in 1986 are treated as changes to reserves in taxable years beginning in 1987, and are subject to discounting. *Reserve strengthening is considered to include all additions to reserves attributable to an increase in an estimate of a reserve established for a prior accident year (taking into account claims paid with respect to that accident year)*, and all additions to reserves resulting from a change in the assumptions (other than changes in assumed interest rates applicable to reserves for the 1986 accident year) used in estimating losses for the 1986 accident year, as well as all unspecified or unallocated additions to loss reserves. This provision is intended to prevent taxpayers from artificially increasing the

amount of income that is forgiven under the fresh start provision.

In 1992, the Treasury promulgated a regulation to interpret and implement the reserve strengthening transitional rule. Section 1.846-3 of the Treasury Regulations, 26 C.F.R. 1.846-3, provides:

(c) *Rules for determining the amount of reserve strengthening (weakening)*—(1) *In general.* The amount of reserve strengthening (weakening) is the amount that is determined under paragraph (c)(2) or (3) to have been added to (subtracted from) an unpaid loss reserve in a taxable year beginning in 1986. For purposes of section 1023(e)(3)(B) of the 1986 Act, the amount of reserve strengthening (weakening) must be determined separately for each unpaid loss reserve by applying the rules of this paragraph (c). This determination is made without regard to the reasonableness of the amount of the unpaid loss reserve and without regard to the taxpayer's discretion, or lack thereof, in establishing the amount of the unpaid loss reserve. * * *

* * * * *

(3) *Accident years before 1986*—(i) *In general.* For each taxable year beginning in 1986, the amount of reserve strengthening (weakening) for an unpaid loss reserve for an accident year before 1986 is the amount by which the reserve at the end of that taxable year [*i.e.*, 1986] exceeds (is less than)—

(A) The reserve at the end of the immediately preceding taxable year [*i.e.*, 1985]; reduced by

(B) Claims paid and loss adjustment expenses paid ("loss payments") in the taxable year beginning in 1986 with respect to losses that are attributable to the reserve. * * * [7]

In an accompanying explanation, the Treasury observed that the broad definition of reserve strengthening provided by the regulation conformed to the Conference Committee Report (1992-2 C.B. 146, 148):

> The legislative history indicates that for purposes of the fresh start adjustment the term "reserve strengthening" includes "all additions to reserves attributable to an increase in an estimate of reserves established for a prior accident year (taking into account claims paid with respect to that accident year), * * * as well as all unspecified or unallocated additions to loss reserves". * * * Thus, Congress adopted an expansive and mechanical definition of reserve strengthening that is reflected in the final regulations.

2. *The regulation correctly interprets the term "reserve strengthening" in Section 1023(e)(3)(B) of the Tax Reform Act of 1986.* The Court has consistently held that "Treasury Regulations 'must be

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[7] The final regulations provide two exceptions from this rule: (1) an amount added to a reserve in 1986 as a result of a loss reported to the taxpayer from a mandatory state or federal assigned risk pool if the amount of the loss reported is not discretionary with the taxpayer; and (2) payments made with respect to reinsurance assumed during 1986 or amounts added to the reserve to take into account reinsurance assumed for a line of business during 1986, but only to the extent the amount does not exceed the amount of a hypothetical reserve for the reinsurance assumed. 26 C.F.R. 1.846-3(c)(3)(ii). Neither exception applies in this case.

sustained unless unreasonable and plainly inconsistent with the revenue statutes.'" *Commissioner* v. *Portland Cement Co.*, 450 U.S. 156, 169 (1981), quoting *Commissioner* v. *South Texas Lumber Co.*, 333 U.S. 496, 501 (1948). "The choice among reasonable interpretations is for the Commissioner, not the courts." *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 488 (1979). See also *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-843 (1984). Deference is given to the Commissioner's interpretations of tax statutes because (*National Muffler Dealers Ass'n* v. *United States*, 440 U.S. at 477):

> "Congress has delegated to the * * * Commissioner * * *, not to the courts, the task of prescribing 'all needful rules and regulations for the enforcement' of the Internal Revenue Code. 26 U.S.C. § 7805(a)." *United States* v. *Correll*, 389 U.S., at 307. That delegation helps ensure that in "this area of limitless factual variations," *ibid.*, like cases will be treated alike. It also helps guarantee that the rules will be written by "masters of the subject," *United States* v. *Moore*, 95 U.S. 760, 763 (1878), who will be responsible for putting the rules into effect.

Applying this established rule of deference in this case, the court of appeals correctly concluded that the definition of "reserve strengthening" contained in the regulation is a reasonable interpretation that is not "plainly inconsistent with the revenue statute[]" and must therefore be upheld (*Commissioner* v. *South Texas Lumber Co.*, 333 U.S. at 501).

a. *The regulation is not "plainly inconsistent" with the statute.* "In ascertaining the plain meaning

of the statute, the court must look to the particular statutory language at issue, as well as the language and design of the statute as a whole." *Sullivan* v. *Stroop*, 496 U.S. 478, 482 (1990), quoting *K Mart Corp.* v. *Cartier, Inc.*, 486 U.S. 281, 291-292 (1988). As both of the courts of appeals that have addressed "the language and design" of this statute have concluded, "[t]he meaning of reserve strengthening is not immediately apparent from the face of this provision." *Western National Mutual Ins. Co.* v. *Commissioner*, 65 F.3d at 92. "The statute does not provide a definition" of the term (*ibid.*), nor does the dictionary, nor does any common usage. And, while petitioner continues to assert that industry practice provides a definitive meaning to the concept of "reserve strengthening" (Pet. Br. 27-28), even its own expert witnesses conceded, in the course of their efforts to "construct[] a working definition of the term" (J.A. 68), that "the term *reserve strengthening* is not a well-defined [property and casualty] insurance or actuarial term of art" (J.A. 60). Petitioner's witnesses acknowledged that the term has different meanings and different usages for "claims managers," "financial executives," "insurance analysts," and others (J.A. 64-66). Industry witnesses consistently noted that "the term 'reserve strengthening' has various meanings, rather than a single universal meaning," and that its meaning varies depending upon the context in which the term is used (J.A. 124). See also J.A. 125, 191, 200. As one expert summarized, even among insurance actuaries, the term is used "in ways that are conflicting and confusing." J.A. 187.[8]

[8] Petitioner errs in suggesting (Pet. 28) that government witnesses supported the narrow definition of "reserve strengthening" that was proposed by petitioner's expert. In fact, the government witnesses stated that the definition proposed by petitioner's expert "is a restricted definition and is not the most commonly understood definition" of reserve strengthening (J.A. 191). See also note 9, *infra*.

The court of appeals thus correctly concluded that "the term 'reserve strengthening' as used in section 1023(e)(3)(B) is subject to more than one interpretation" (Pet. App. A9).[9]

That the text of the statute lacks a "plain" meaning is demonstrated by the very fact that petitioner found it necessary to have recourse to "expert" testimony to "construct[] a working definition" (J.A. 68) of "reserve strengthening" from among the several different usages of that term within the insurance industry.[10] Once a court undertakes to investigate sources

[9] Like the court of appeals, the Tax Court noted that the Commissioner "presented expert testimony which indicates that the term is subject to more than one interpretation" and that "[o]ne expert opined that the regulation's definition provided a valid measurement of 'reserve strengthening'" (Pet. App. A43). Any contention that a single, industry definition exists for the term "reserve strengthening" is thus not consistent with the record and was not accepted by either of the courts below. Indeed, petitioner implicitly acknowledges that fact, for it now asserts that "there is ultimately no need for experts to validate the meaning of the statutory term" (Pet. Br. 32). We agree that the meaning of the ambiguous statutory term should be determined by review of the legislative history, rather than from the testimony of the expert witnesses engaged to describe the multiple, inconsistent industry usages of the term.

[10] In *Massachusetts* v. *Blackstone Valley Electric Co.*, 67 F.3d 981, 986-987 (1st Cir. 1995), the court held that a statutory term is ambiguous when conflicting expert explanations reveal an inconsistent usage of the term. As the court stated in *Brechteen Co.* v. *United States*, 854 F.2d 1301, 1303 (Fed. Cir.

beyond the mere text of the statute to determine its meaning, it is obviously the legislative history of the statute—rather than the carefully worded reports of hired witnesses—that is the best source for determining the intent of Congress. It is, after all, the intent of Congress, not the persuasive powers of expert witnesses, that should govern construction of a statute. As this Court has emphasized, when a statutory term such as "reserve strengthening" lacks an obvious or plain meaning, the interpretive regulation of the agency charged with its enforcement should be upheld "unless the legislative history or the purpose and structure of the statute clearly reveal a contrary intent on the part of Congress." *Chemical Manufacturers Ass'n* v. *Natural Resources Defense Council, Inc.*, 470 U.S. 116, 126 (1985).[11]

1988), "if words are really and truly plain, it ought not to be necessary to establish their meaning by recourse to technical or scientific dictionaries where definitions contrary to common speech may often be found." See also *National Railroad Passenger Corp.* v. *Boston & Maine Corp.*, 503 U.S. 407, 418 (1992) ("The existence of alternative dictionary definitions of the word 'required,' each making some sense under the statute, itself indicates that the statute is open to interpretation.").

[11] Petitioner misapprehends the "plain meaning" rule of statutory construction. The principle that courts ordinarily will not consult legislative history in construing unambiguous statutes applies only when the statute is "plain and unambiguous on its face." *TVA* v. *Hill*, 437 U.S. 153, 184 n.29 (1978). That principle does not apply to terms such as "reserve strengthening" which lack a "plain and unambiguous" meaning. When the statute is not "plain and unambiguous on its face," the Court "seek[s] guidance in the statutory structure, relevant legislative history, congressional purposes expressed in the [statute], and general principles respecting the proper

b. *The regulation is directly supported by the legislative history and the structure of the statute.* The court of appeals correctly concluded that the agency's interpretive regulation draws direct and substantial support from the legislative history of the statute. The Conference Report, which is entitled to great weight in interpreting the statute (*National Ass'n of Greeting Card Publishers* v. *United States Postal Service*, 462 U.S. 810, 832 n.28 (1983)), expressly states, as the regulation provides, that the term "[r]eserve strengthening is considered to include all additions to reserves attributable to an increase in an estimate of a reserve established for a prior [*i.e.*, a pre-1986] accident year" (Pet. App. A17, quoting H.R. Conf. Rep. No. 841, *supra*, at II-367).[12]

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allocation of judicial authority to review agency orders." *Florida Power & Light Co.* v. *Lorion*, 470 U.S. 729, 737 (1985).

The fallacy in petitioner's argument is further evidenced by its reliance on other statutes involving the *life* insurance industry in an effort to ascertain a "plain meaning" for the term "reserve strengthening" in Section 1032(e)(3)(B) of the 1986 Act. See pages 26-35, *infra*. If the meaning of Section 1023(e)(3)(B) were "plain," those other statutes would be irrelevant. See *Greenport Basin & Construction Co.* v. *United States*, 260 U.S. 512, 516 (1923) ("As the language of the act is clear, there is no room for the argument of plaintiff drawn from other revenue measures"); 2B N. Singer, *Sutherland Statutory Construction* § 51.01, at 117 (5th ed. 1992) ("[I]n line with the basic rule on the use of extrinsic aids, other statutes may not be resorted to if the statute is clear and unambiguous.").

[12] The Conference Report further explains that "reserve strengthening" for the *1986* accident year encompasses only those "additions to reserves *resulting from a change in the assumptions* (other than changes in assumed interest rates applicable to reserves for the 1986 accident year) *used in estimating losses for the 1986 accident year*." H.R. Conf. Rep.

As both courts below correctly recognized (Pet. App. A25, A41), the broad definition of "reserve strengthening" provided by the regulation is thus perfectly consistent with the explanation and definition of that term contained in the Conference Report.

The court of appeals also correctly observed that the Conference Committee revision of the Senate version of Section 1023(e)(3)(B) further demonstrates that Congress did *not* intend to restrict "reserve strengthening" to changes in reserves that result only from changes in reserve practices. The Senate version of the bill had contained additional language that explicitly linked the scope of "reserve strengthening" to changes in reserve methodologies from those used in the prior year. See note 6, *supra*. That Senate provision, however, was rejected and deleted

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No. 841, *supra*, at II-367 (emphasis added). The Report thus (i) provides different explanations of the term "reserve strengthening" for additions to reserves for pre-1986 accident years than for additions to reserves for the 1986 accident year, (ii) limits that term to additions to reserves attributable to changes in underlying assumptions *only* with respect to the 1986 accident year and (iii) provides a broader definition of that same term to encompass "all" additions to reserves for pre-1986 accident years. The different applications of the term "reserve strengthening" for pre-1986 accident years and for the 1986 accident year result from the fact that there are no reserves (and thus no reserves to "strengthen") for 1986 accidents prior to the beginning of that year. Section 1.846-3(c)(2) of the Treasury Regulations defines "reserve strengthening" for the 1986 accident year in exact conformity with the definition contained in the Conference Committee Report and that aspect of the regulation is not challenged in this case. See Pet. App. A52-A53.

by the Conference Committee.[13] In doing so, the Conference Committee emphasized that "[t]he conference agreement modifies the Senate amendment with respect to the treatment of reserve strengthening" and provides a more expansive definition of that term than the Senate Finance Committee had provided. H.R. Conf. Rep. No. 841, *supra*, at II-367.

As the court of appeals emphasized (Pet. App. A18-A19), Congress consciously and intentionally rejected the limiting language contained in the "reserve strengthening" provision of the Senate version of the bill. Senator Wallop, who was an opponent of that change, extensively commented on that very fact. He explained that "the reserve strengthening feature [of the Senate bill] was significantly modified in conference" and that the broader Conference Committee definition was based on "the notion that reserve strengthening actions taken by insurance companies during 1986 for prior accident years is heavily motivated by the desire to avoid Federal income taxes." 132 Cong. Rec. 32,625 (1986).[14] Although such

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[13] Petitioner is wrong in stating that "the deletion of that sentence [in the Senate bill] from the actual 1986 Act is unexplained" and in speculating that it was removed by the Conference Committee either due to an adjustment of the starting date for the reserve strengthening provision or because of its reference to a "contract" (Pet. Br. 41-42). The rejection of the Senate version of the bill was explained both by Senator Wallop and by the Conference Report. It was rejected in Conference precisely to ensure that the term "reserve strengthening" would apply broadly to "all" additions to reserves and would not be limited only to changes in reserves resulting from changes in reserve methodologies. H.R. Conf. Rep. No. 841, *supra*, at II-367.

[14] Although Senator Wallop stated that he disagreed with the Conference Committee's approach, he acknowledged "that

"statements by individual legislators should not be given controlling effect, * * * when they are consistent with the statutory language and other legislative history, they provide evidence of Congress' intent." *Brock* v. *Pierce County*, 476 U.S. 253, 263 (1986).

Petitioner's position in this case is thus ultimately based on the untenable proposition that this Court should adopt the very version of Section 1023(e)(3)(B) that had been proposed by the Senate but rejected by the Conference Committee. As this Court has emphasized, however, courts have a "duty to refrain from reading a phrase into the statute when Congress has left it out." *Keene Corp.* v. *United States*, 508 U.S. 200, 208 (1993).

c. *The interpretation of the term "reserve strengthening" contained in the regulation advances the purpose of the statute.* The court of appeals also correctly concluded (Pet. App. A22-A23) that the definition of "reserve strengthening" contained in the regulation advances the purpose of the statute by preventing abuses of the fresh start provision. The Conference Report explains that the requirement that "all additions to reserves" be treated as "reserve strengthening" is intended to "prevent taxpayers from artificially increasing the amount of income that is forgiven under the fresh start provi-

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increases in reserves decrease an insurance company's Federal tax burden." 132 Cong. Rec. 32,625 (1986). His personal view was that "[t]he Senate bill's reserve strengthening provision was fair" and that "[t]he conference modification substitutes a simplistic, cook-book approach that is entirely inappropriate" (*ibid.*).

sion." H.R. Conf. Rep. No. 841, *supra*, at II-367.[15] As the court of appeals correctly observed, to interpret the term "artificial" in the Conference Report as narrowing the definition of "reserve strengthening" to additions to reserves attributable to changes in reserve practice "would mean that the Conference Committee intentionally contradicted itself" (Pet. App. A23). Instead, as Senator Wallop recognized in his comments criticizing the Conference Committee revisions of the Senate bill (*id.* at A18, quoting 132 Cong. Rec. 32,625 (1986)), the Conference Committee adopted its broad definition of "reserve strengthening" because it concluded that a broad, prophylactic, "cook-book" rule was needed to preclude property and casualty companies from taking artificial advantage of the fresh start provision by increasing their reserves for pre-1986 accident years. See notes 13 & 14, *supra*.

The broad definition of "reserve strengthening" adopted by the Conference Committee is a response to the fact that property and casualty companies exercise a wide discretion in setting reserves and could therefore seek to take advantage of the statutory fresh start under the guise of making "routine" reserve adjustments. The "manipulation of [property and casualty loss] reserves to produce the desired operating results is a constant danger." T. Peterson, *Loss-Reserving—Property/Casualty Insurance* 11 (1981). Indeed, recently published surveys of "aggre-

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[15] As Judge Halpern noted in dissent in the Tax Court's decision in *Western National*, 102 T.C. at 373, the term "artificial" refers to "artful" or "cunning" increases in reserves. See *Webster's Third New International Dictionary* 124 (1986).

gate industry data" conducted for 1985-1987 are "broadly consistent" with the conclusion that "tax-motivated reserving" occurred in the property and casualty industry during that period. Bradford & Logue, *The Influence of Income Tax Rules on Insurance Reserves* 34-35 (National Bureau of Economic Research, Working Paper 5902 (1997)).

This is not, of course, to suggest that *every* insurer sought to indulge in "tax-motivated reserving" during this time period. It does, however, reflect that it was reasonable for Congress to conclude that a prophylactic rule was an appropriate response to potential abuse of the fresh start provision. As Judge Friendly stated in *Commissioner* v. *Pepsi-Cola Niagara Bottling Corp.*, 399 F.2d 390, 392 (2d Cir. 1968), "a legislature seeking to catch a particular abuse may find it necessary to cast a wider net."

3. *The prior legislation on which petitioner relies does not support a contrary conclusion.* Notwithstanding the facial ambiguity of the phrase "reserve strengthening," petitioner contends that a "plain" meaning for the term can be found from its "longstanding use in insurance tax law" and from its "prior use in a virtually identical provision" enacted in 1984 (Pet. Br. 28). These contentions are not correct.

a. Petitioner asserts that the term "reserve strengthening" has a "longstanding use" in insurance tax law to describe only additions to insurance reserves that result from changes in reserve assumptions or methodologies. The statutes and regulations that petitioner cites (Pet. Br. 15-17), however, do not purport to define the term "reserve strengthening." Instead, they implement the statutory scheme of the Life Insurance Company Income Tax Act of 1959,

Pub. L. No. 86-69, 73 Stat. 112. That Act does not refer to, or even contain, the term "reserve strengthening." Instead, it provided detailed tax consequences for changes in "the basis" employed by insurers in determining their life insurance reserves. See 26 U.S.C. 810(d)(1) (1976). The Act generally required life insurance companies to spread over a ten-year period the loss deduction associated with any increase of reserves resulting from a change in "the basis" of the reserve accounting method that they employed. *Ibid.*

The regulation that implemented that statutory requirement also did not purport to define the term "reserve strengthening," for that term was not contained in the statute. In describing the sort of changes in "the basis" of reserve accounting that the statute addresses, the regulation used the term "reserve strengthening" only in a caption. 26 C.F.R. 1.810-3(a). That term was not thereafter defined or even mentioned in the text of that regulation. See *ibid.*[16]

A change in reserves that results from a change in "the basis" of setting reserves is, of course, only one type of "reserve strengthening." It is not the *only* type of reserve strengthening known in the insurance industry and does not represent an exclusive or comprehensive definition of that term. See pages 18-

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[16] The regulation issued under Section 810(d)(1) provides an example of how that statute applied in the context of "reserve strengthening *attributable to the change in basis*" (26 C.F.R. 1.810-3(b), Ex. 2) (emphasis added). Nothing in that regulation, or in that statute, purports to provide any comprehensive definition (or, indeed, any definition at all) for the term "reserve strengthening" as used throughout the entire insurance industry.

20 & note 16, *supra*. Instead, as the Conference Committee Report on the statute involved in this case states, "reserve strengthening" also refers more generally to "all additions to reserves attributable to an increase in an estimate of a reserve established for a prior accident year" (Pet. App. A17, quoting H.R. Conf. Rep. No. 841, *supra*, at II-367).

Unlike the statute involved in the present case, the narrow focus of Section 810(d)(1) in the Life Insurance Company Income Tax Act of 1959 was only on changes in "the basis" of accounting for reserves. That statute, by its very terms, did not purport to apply broadly to all "reserve strengthening" actions and the concept of "reserve strengthening" does not even appear in the statutory text. The court of appeals therefore correctly rejected petitioner's suggestion that the rulings and decisions that employ the term "reserve strengthening" in describing the application of the limitations formerly contained in Section 810(d)(1) on changes in "the basis" of reserving life insurance claims establish a comprehensive definition of the term "reserve strengthening" for all purposes (Pet. App. A12-A13).[17] In particular, as the court emphasized, neither that statute nor its regulation purports to define the term "reserve strengthening" in the property and casualty industry to mean

[17] The decisions cited by petitioner do not purport to establish a definition of "reserve strengthening" for property and casualty industry purposes. See Pet. Br. 18, citing *Jefferson Standard Life Ins. Co.* v. *United States*, 408 F.2d 842, 850 (4th Cir.), cert. denied, 396 U.S. 828 (1969), and *National Life & Accident Ins. Co.* v. *United States*, 381 F. Supp. 1034, 1037 (M.D. Tenn. 1974), aff'd, 524 F.2d 559 (6th Cir. 1975).

only changes in "the basis" or method employed for reserve accounting (*id.* at A13-A14).[18]

Moreover, "life insurance companies and [property and casualty] insurers are taxed in entirely separate manners. Gross income as well as loss reserves are computed on different bases and assumptions." Pet. App. A12.[19] These differences in the taxation of life

[18] Petitioner errs in stating (Pet. Br. 18) that there is precedent involving property and casualty companies that "shows that the term 'reserve strengthening' consistently has been used for insurance tax purposes to mean increases in reserves involving changes in assumptions or methodologies." The precedent cited by petitioner involves the calculation of life insurance reserves under the former provisions of the Life Insurance Company Income Tax Act of 1959. The single authority cited by petitioner (Pet. Br. 17-18) involving a property and casualty company—Rev. Rul. 65-240, 1965-2 C.B. 236—addressed the *life* insurance reserves of a company that had issued both life and property and casualty insurance. As the court of appeals correctly noted in rejecting petitioner's reliance on these authorities, the rulings issued under the Life Insurance Company Income Tax Act of 1959 "do not define reserve strengthening with respect to P & C loss reserves" (Pet. App. A13-A14).

[19] There are fundamental differences between the reserve-setting processes for life insurance and other types of insurance that preclude the facile importation of life insurance reserve concepts into statutes dealing with other types of insurers. Life insurance reserves are computed on the basis of recognized mortality tables and assumed rates of interest. 26 U.S.C. 816(b)(1). See *National Life & Accident Ins. Co.* v. *United States*, 381 F. Supp. at 1037. "Unlike life insurance reserves, which are based on rather reliable studies of prior mortality experience for large age groups, property and liability loss reserves must take into account expected loss experience, using everchanging risk circumstances." C. Galloway & J. Galloway, *Handbook of Accounting for Insurance Companies* 227-228 (1986). See also J.A. 30 ("P/C insurers generally establish case

insurance companies and other insurers are the sort of "variables [that] render every problem of statutory construction unique" (*United States* v. *Universal C.I.T. Credit Corp.*, 344 U.S. 218, 221 (1952)). See *Alinco Life Ins. Co.* v. *United States*, 373 F.2d 336, 352 (Ct. Cl. 1967) (tax provisions relating "primarily to casualty-type insurance * * * are rather meaningless in pure life insurance"). Indeed, petitioner's experts did not even advert to life insurance practices in their testimony concerning the concept of "reserve strengthening" in the property and casualty industry (J.A. 49-120). They acknowledged instead that "the term 'reserve strengthening' is not a well-defined PC insurance or actuarial term of art to be found in PC actuarial, accounting, or insurance regulatory literature" (J.A. 60).

The "longstanding" provisions of the Life Insurance Company Income Tax Act of 1959 that govern the tax consequences of changes in "the basis" of life insurance reserves thus do not define the concept of "reserve strengthening" in the property and casualty industry. Nothing in the text or history of Section 1023(e)(3)(B) of the 1986 Act suggests that Congress sought to incorporate the distinctly different text of the 1959 Act. Indeed, if Congress *had* desired in 1986 to limit the concept of "reserve strengthening" in Section 1023(e)(3)(B) to changes in "the basis" of calculating reserves (26 U.S.C. 810(d)(1) (1976)), there would obviously have been no reason to reject the Senate version of the 1986 bill. The Senate version,

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reserves by using estimates of individual claims made by individual claims adjusters, whose estimates are usually revised over time according to the available information and individual judgment and experience of the adjuster").

however, *was* rejected precisely because Congress desired to ensure that "all" reserve increases would be encompassed within the "reserve strengthening" limitation of the fresh start provision. See pages 22-25, *supra*.

b. Petitioner similarly errs in contending (Pet. Br. 20-25) that the term "reserve strengthening" in Section 1023(e)(3)(B) of the 1986 Act draws a "plain" meaning from the statutory reference to "reserve strengthening" in Section 216(b) of the Tax Reform Act of 1984, Pub. L. No. 98-369, Div. A, 98 Stat. 759.[20] In the latter provision, Congress provided a fresh start adjustment for life insurance reserves and, in making that adjustment inapplicable to "any reserve strengthening" in 1983, added a sentence to that statute that expressly specified that the "reserve strengthening" limitation "shall not apply * * * if [the reserve] computation employs the reserve practice used * * * before * * * for the type of

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[20] The 1984 legislation provided (emphasis added):

(3) *Reinsurance transactions, and reserve strengthening, after September 27, 1983.*—

(A) *In general.*—Paragraph (1) [*i.e.*, the fresh start adjustment] shall not apply * * *

* * * * *

(ii) to any reserve strengthening reported for Federal income tax purposes after September 27, 1983, for a taxable year ending before January 1, 1984.

Clause (ii) shall not apply to the computation of reserves on any contract issued if such computation employs the reserve practice used for purposes of the most recent annual statement filed before September 27, 1983, for the type of contract with respect to which such reserves are set up.

[insurance] with respect to which such reserves are set up." *Ibid.*

As the court of appeals correctly concluded (Pet. App. A14-A15), the "reserve strengthening" provision applicable to life insurance reserve computations under the 1984 provision *supports* the Treasury's interpretation of the term "reserve strengthening" as used in Section 1023(e)(3)(B) of the 1986 Act. In enacting the life insurance provisions in 1984, Congress added language to the statute that explicitly *excluded* ordinary increases in reserves—increases that did not result from a change in reserve practices—from the operation of the "reserve strengthening" clause. A similar exclusion was proposed in the Senate version of Section 1023(e)(3)(B) of the 1986 legislation, but that exclusion was purposefully deleted by the Conference Committee. As the court of appeals correctly observed (Pet. App. A14), the deletion of this exclusion of ordinary reserve increases from the operation of the "reserve strengthening" clause plainly indicates that Congress did *not* intend to restrict the "reserve strengthening" provision in Section 1023(e)(3)(B) to changes in reserve practices.[21] "Where Congress includes limiting language in an earlier version of a bill but deletes it prior to enactment, it may be presumed that the limitation

[21] The Conference Committee Report emphasizes that "[t]he conference agreement modifies the Senate amendment with respect to the treatment of reserve strengthening" and provides a more expansive definition of the term (for pre-1986 accident years) than the Senate Finance Committee had provided. H.R. Conf. Rep. No. 841, *supra*, at II-367.

was not intended." *Russello* v. *United States*, 464 U.S. 16, 23-24 (1983). See also pages 22-25, *supra*.[22]

c. Petitioner relies (Pet. 14-15) on several cases that invoke the familiar principle of statutory construction that, when Congress uses the same terms in the same (or closely related) statutes, those terms are presumed to have the same meaning. For the reasons that we have explained, however, that principle does not help petitioner in this case. Congress used different language in different contexts to address different subjects in these statutes.[23]

[22] Petitioner strains (Pet. Br. 38-42) to avoid the obvious implication of the additional language in the 1984 Act. Congress specified in 1984 that the "reserve strengthening" limitation on the fresh start provision for life insurance companies was not to apply if the insurer "employs the reserve practice used for purposes of the most recent annual statement filed before September 27, 1983" (Pet. Br. 39). Petitioner contends that this restriction on "reserve strengthening" in the 1984 provision was intended to apply only "for contracts that were newly 'issued' in 1983" (*id.* at 40). That assertion, however, is hardly helpful to petitioner. Under petitioner's theory, the term "reserve strengthening" would have incorporated that limitation *without* the additional text in the statute. Petitioner fails to acknowledge that, if the term "reserve strengthening" has the meaning that petitioner asserts, the *express* language making the 1984 provision inapplicable "if such computation employs the reserve practice [previously] used" would have been unnecessary.

[23] Moreover, the principle that similar terms in the same or related statutes are presumed to have the same meaning is not an inexorable rule of law. It is instead an "axiom of experience" employed in the absence of differing circumstances or contrary evidence of legislative intent. See *NationsBank of North Carolina, N.A.* v. *Variable Annuity Life Ins. Co.*, 513 U.S. 251, 262 (1995). The principle cannot trump the intention of Congress as expressed in the Conference Committee Report.

The Life Insurance Company Income Tax Act of 1959, on which petitioner relies, concerned the tax treatment of life insurance reserves and used significantly different language than Congress employed in Section 1023(e)(3)(B) of the 1986 Act. See pages 26-27, *supra*. And, although petitioner emphasizes that the 1984 "reserve strengthening" provision for the life insurance industry was "virtually" identical to the 1986 provision involved in this case (Pet. Br. 28, 32), petitioner fails to acknowledge the obvious fact that the two provisions are not "precisely" identical. They differ in this one important respect: the 1984 provision excluded from the "reserve strengthening" provision any changes in reserves that did not result from changes in reserve practices; the 1986 provision contained no such exclusion. Instead, as the Conference Committee emphasized in describing the operation of the statute, the "reserve strengthening"

That report is entitled to "great weight" in ascertaining the meaning of the legislation (*National Ass'n of Greeting Card Publishers* v. *United States Postal Service*, 462 U.S. at 832 n.28) for, "next to the statute itself," it "is the most persuasive evidence of congressional intent" (*Demby* v. *Schweiker*, 671 F.2d 507, 510 (D.C. Cir. 1981)). See also *Farmers Reservoir & Irrigation Co.* v. *McComb*, 337 U.S. 755, 764 (1949) (explaining that the Court has "consistently refused to pervert the process of interpretation by mechanically applying definitions in unintended contexts" in a manner that would conflict with the demonstrable intent of Congress). As this Court has emphasized, "[i]nstead of balancing the various generalized axioms of experience in construing legislation, regard for the specific history of the legislative process that culminated in the Act now before us affords more solid ground for giving it appropriate meaning." *United States* v. *Universal C.I.T. Credit Corp.*, 344 U.S. at 222 (Frankfurter, J.).

provision in Section 1023(e)(3)(B) of the 1986 Act applies (as the regulation states) to "all" changes in reserve estimates. H.R. Conf. Rep. No. 841, *supra*, at II-367.

The Treasury Regulation that interprets the language of Section 1023 faithfully honors the crucial distinctions that occupied the attention of Congress in enacting the statute. The interpretation proposed by petitioner ignores them.

Petitioner observes (Pet. Br. 29) that Congress *could* have provided an express definition of the term "reserve strengthening" in the text of Section 1023(e)(3)(B). That observation, however, sheds no light on the proper meaning of that term. It merely points out why it was appropriate and helpful for the agency to issue an interpretive regulation that explains the ambiguous text of the statute. See note 12, *supra*. In issuing that regulation, the agency properly respected the textual distinctions that Congress employed and correctly gave "great weight" to the Conference Committee Report in ascertaining the intent of the legislation (*National Ass'n of Greeting Card Publishers* v. *United States Postal Service*, 462 U.S. at 832 n.28).

4. *By honoring the clear legislative intent, the regulation provides a reasonable interpretation of the statute.* This Court has emphasized that "[t]he choice among reasonable interpretations is for the Commissioner, not the courts." *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. at 488. The court of appeals properly rejected petitioner's contention (Pet. Br. 45-49) that the regulation is not "reasonable" because it produces "anomalous" and "inequitable" results (Pet. App. A23-A25). As the court

observed (*id.* at A23-A24), the broad definition of "reserve strengthening" provided by the regulation reflects Congress's intent. "[W]e as judges cannot override the specific policy judgments made by Congress in enacting the statutory provisions with which we are here concerned." *United States* v. *Sotelo*, 436 U.S. 268, 279 (1978).

Petitioner nonetheless asserts that various hypothetical applications of the regulations could result in a determination that "reserve strengthening" has occurred even when no actions concerning "reserve" calculations occurred. Before discussing the alleged defects resulting from such hypothetical applications of the regulation, however, we note that petitioner has not suggested—much less demonstrated—that any of the supposed defects have any practical relevance in the calculation of its tax liability. Petitioner is thus not a proper plaintiff to assert that such hypothetical applications of the regulation are unreasonable.

Petitioner's hypothetical objections to the regulation are, in any event, incorrect. Petitioner addresses only one example of what it deems to be an "unreasonable" result. Petitioner asserts that it is "unreasonable" to define "reserve strengthening" to include the situation in which the insurer pays more for a claim in 1986 than it had reserved for the claim in 1985 (Pet. Br. 47). Petitioner is of the view that this event would have nothing whatever to do with an increase in reserve strength. The stipulation in this case, however, reflects that this fact pattern often (if not ordinarily) *would* occur in connection with an increase in reserves of the type that would constitute

"reserve strengthening" under the statute and regulation. The stipulation explains that (J.A. 37)

> the applicable loss reserve on an individual claim [is automatically debited] whenever a payment [is] made on the claim [and,] as part of approving the payment, the responsible claim adjuster * * * determine[s] whether an adjustment should be made to the loss reserve applicable to the claim.

A payment of an amount in excess of the amount reserved would thus appropriately be accompanied by an increase in the case reserve for that claim, with the reserve then being "reduced to zero" by the payment. *Ibid.* The result is that the reserves for the claim are either actually or constructively "strengthened" at the time of the payment, and then dissipated ("reduced to zero") by the payment.[24]

Moreover, in objecting to this and similar hypothetical examples of what are claimed to be unreasonable applications of the regulation, petitioner ignores

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[24] The definition of "reserve strengthening" for pre-1986 accident years is the amount by which the total reserves for those accident years at the end of 1986 plus the payments on claims for those years made during 1986 exceed the total reserves established for those years at the end of 1985. 26 C.F.R. 1.846-3(c)(3). See H.R. Conf. Rep. No. 841, *supra*, at II-367. For example, if no reserve existed at the end of 1985 for a claim paid in 1986, reserve strengthening could exist under the regulation in the amount of the payment. That application of "reserve strengthening" is consistent with the fact that case reserves would be either constructively or actually increased by the insurer in 1986 at the time of the payment. See J.A. 37. On the other hand, if IBNR ("incurred but not reported") reserves were reduced at the time of payment (see notes 25-27 and accompanying text, *infra*), no reserve strengthening would occur under the regulation.

the consequences that such events may have on the calculation of the IBNR reserve for claims "incurred but not reported." Even the facts recited in the above example would *not* result in "reserve strengthening" under the regulation if, as the stipulation describes, the insurer estimates its "IBNR reserves by estimating ultimate losses to be incurred for an accident year * * * then subtracting paid losses to date and case estimates of reported losses" (J.A. 31). For an insurer using that method of determining IBNR, that reserve account is decreased by the amount of the payment but increased by the amount of any case reserves written off.[25] If payment is made on a claim in an amount in excess of the established case reserve, and no corresponding increase to the case reserve occurs,[26] then (i) the IBNR reserve for the

[25] For example, if an insurer that has IBNR reserves of 2000 and a case reserve for one claim in the amount of 500 made a payment on that claim of 800, if no change were made in the case reserve, the IBNR reserve would be reduced to 1700 (2000 - 800 + 500). By contrast, if a payment were made on the claim that equalled the established case reserve, there would be no change in IBNR (2000 - 800 + 800).

[26] Petititioner does not dispute that "reserve strengthening" (as explained in the Conference Committee Report and defined in the regulation) occurs when the payment is accompanied by a corresponding increase in the case reserves. Petitioner asserts only that it is unreasonable to describe a situation not involving an actual change in reserves as "reserve strengthening." In making that assertion, however, petitioner and its experts focus only on case reserves and do not consider IBNR. Indeed, one of the hypotheticals that petitioner cites (Pet. Br. 47) involves the abstraction of an insurer who "estimates zero IBNR and whose total reserves are comprised solely of aggregate case reserves" (J.A. 86). Because that hypothetical fails to give any consideration to IBNR, it asserts that the establishment of a new case reserve would evidence "reserve strengthening" (*ibid.*). But, as new reserves are established when incurred claims are reported, the ordinary result is an ultimate reduction in the reserve for claims incurred but *not* reported (IBNR reserves). Such offsetting changes would *not* produce "reserve strengthening." It is only by ignoring IBNR that petitioner's hypotheticals yield the "absurd" consequences of which it complains.

insurer would diminish by the amount by which the payment exceeded the case reserve, (ii) the total reserves at the end of the period would also decrease by that amount and (iii) thus no "reserve strengthening" would occur under the regulation.[27] Petitioner's concern over hypothetical misapplications of the regulation thus fails to take into account the fact that adjustments in IBNR may follow from payments in excess of prior reserve amounts—and that those adjustments may offset the payment and accompanying changes in other reserves and result in no reserve strengthening under the regulation.

Moreover, the court of appeals correctly concluded (Pet. App. A23) that petitioner's "anomalous results" argument is based on an unrealistic example. Petitioner's hypothetical (derived from the opinion of the Tax Court majority in *Western National*) assumes that an insurer's claims are resolved in 1986 by payment of an amount that is significantly above the

[27] That is because total reserves equal case reserves plus IBNR plus loss adjustment expense reserves. See page 2, *supra*. If IBNR were diminished by the amount of the payment in excess of the case reserve (see note 25, *supra*), then total reserves would be reduced by the amount of the payment (because the reduction in IBNR plus the reduction in the case reserve to zero when the claim is paid (J.A. 37) would equal the amount of the payment). Because total reserves are reduced by the amount of the payment, no "reserve strengthening" occurs under the regulation. See note 24, *supra*.

amount reserved for it. In reality, however, a company would resolve hundreds or thousands of claims in each year. Some will be resolved at amounts in excess of their reserves; some will be resolved at amounts less than their established reserves. As a result, the "law of large numbers" (M. Dorfman, *Introduction to Insurance* 9 (3d ed. 1987)) would operate to make the Commissioner's definition of "reserve strengthening" appropriate even in the absence of directly compensating adjustments in IBNR or elsewhere in the insurer's reserve accounts. If reserves are correctly estimated, there is no *a priori* reason to assume that claims resolved by payment of amounts in excess of the amounts reserved would dramatically exceed claims resolved by payment of amounts below the amounts reserved.

As the court of appeals concluded (Pet. App. A24 n.13), the challenged regulation would be a "reasonable" implementation of the statutory command even if it did not anticipate every conceivable permutation of possible facts. See *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 371 (1973). The regulatory definition of "reserve strengthening" coincides exactly with the definition of that term contained in the Conference Report. The regulation thus provides a "reasonable" interpretation precisely because it faithfully adheres to the text and clear history of the statute. The consequences that petitioner incorrectly labels as "absurd" are, in any event, simply the consequences that Congress intended by adopting a prophylactic, "cook-book" rule. See note 14, *supra*. Although petitioner and other opponents of that legislation view the statutory "approach" as "simplistic" and "inappropriate" (*ibid.*), Congress obviously reached a different conclusion,

for it rejected that very criticism in enacting the statute. As this Court observed in *United States* v. *Correll*, 389 U.S. at 306-307 (footnotes and internal quotation marks omitted):

> Alternatives to the Commissioner's * * * rule are of course available. Improvements might be imagined. But we do not sit as a committee of revision to perfect the administration of the tax laws. * * * In this area of limitless factual variations, it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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